

Sales Tax and Performance Contracts

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Overview

- Presentation of Issue
- Specific Examples
- Possible Options



Presentation of Issue

- Generally, sales of tangible personal property are subject to sales and use taxes
- Generally, contracts for the provision of services are not subject to sales and use taxes

What about gray areas where the transaction involves both tangible personal property and services?

- Is it the sale of tangible personal property with installation services?
- Is it a performance contract?

Sale of TPP with Installation

- Tenor of agreement is for sale or purchase of property
 - Generally involves sale of specific items or quantities of tangible personal property
 - Vendor will erect or install tangible personal property for additional charge
 - Title to tangible personal property passes to owner (not contractor) when delivered to site; retailer not liable for loss or damage due to vandalism, neglect, theft, fire
- Retailer purchases tangible personal property exempt from tax; charges owner tax on sales price – installation exempt if separately stated on the invoice at the time of sale (Note: the owner may instead owe tax under Article 5F if the property qualifies as mill machinery)

Performance Contract

- Tenor of agreement is for contractor to perform job
 - Contractor retains right to control means, method, and manner of accomplishing the desired result
 - Does not provide for sale of specific items or quantities of tangible personal property; contractor furnishes necessary materials, labor, and expertise to accomplish job
 - Title to materials purchased by contractor passes to and remains with contractor until job is completed and turned over to (and accepted by) owner
 - Total responsibility for job until it is completed, accepted, and turned over to owner is on contractor
 - Contractor responsible/liable for accidents or injury at job site; loss or damage due to vandalism, neglect, theft, fire
- Contractor owes sales or use tax on items purchased for use in fulfilling contract (Note, the contractor may instead owe tax under Article 5F if the property qualifies as mill machinery)

Tax implications

- Sale of tangible personal property with installation
 - Sales or use tax applies to sales price of tangible personal property to end consumer, including any charges for installation unless separately stated on the invoice at the time of sale
- Performance contract
 - Sales or use tax applies to sales price of tangible personal property when purchased by the contractor



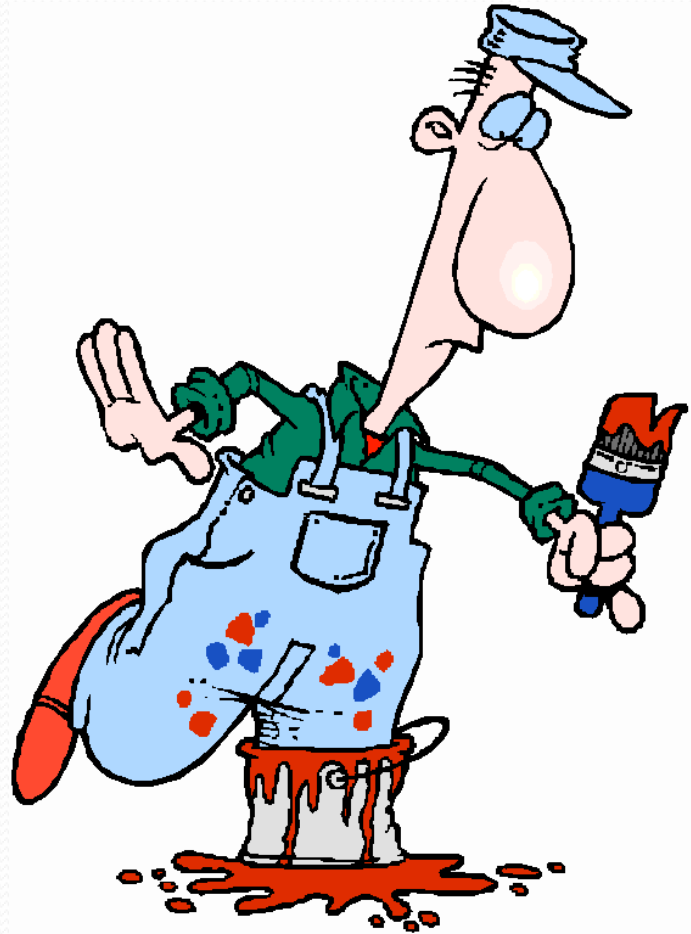
Clear Examples of Sales of TPP with Installation

- Major appliances (refrigerators, dishwashers, etc.)
- High-end entertainment equipment (big-screen televisions, etc.)
- Some fixtures (ceiling fans, some light fixtures)



Clear Examples of Performance Contracts

- Painting motor vehicles or buildings (considered a service rather than a sale of paint)
- Exterminators (not a sale of pesticide)
- Cleaning services (cleaning supplies are used rather than sold)



More Gray Areas...



- Generally, the analysis is more difficult with the installation of “major” fixtures
 - Cabinetry
 - Carpeting

Analysis

- In general, the tenor of the agreement controls
- Is the “seller” a retailer, a contractor, or a retailer-contractor?
 - For sales tax purposes, “retailer” is defined under G.S. 105-164.3
 - There is no specific definition (under statute, rule, or bulletin) for contractor
 - Retailer-contractor is defined by rule and bulletin – it means a business that engages in some transactions as a retailer and other transactions as a contractor

Analysis

- If there is doubt, G.S. 105-164.26 provides that it is presumed:
 - That all gross receipts of wholesale merchants and retailers are subject to the retail sales tax until the contrary is established by proper records as required in this Article.
- Specific guidance is given for some industries under Section 31 of the Sales and Use Tax Technical Bulletins

Cabinetmakers

- **17 NCAC 07B .0803 CABINETMAKERS**
 - (a) Cabinetmakers who fabricate and sell cabinets to homeowners, contractors and others for use in this state are liable for collecting and remitting the applicable statutory state and local sales or use tax on the sales price of such property. Any cost of labor or services rendered in installing or affixing such property when separately stated on sales invoices given to customers at the time of sale shall not be included as a part of the sales price.
 - (b) Cabinetmakers who, pursuant to a construction or performance-type contract with or for the benefit of the owner of real property, install or affix tangible personal property, including cabinets, in or to real property are liable for tax on the cost or purchase price of materials and other such property used in performing the contract.

Cabinets – Rule of Thumb

- Are cabinets sold without an installation agreement?
 - Yes. Treated as a sale of tangible personal property
 - Seller collects sales tax on sales price of cabinets
- Are the cabinets a pre-fabricated product that are installed?
 - Yes. Treated as a sale of tangible personal property with installation
 - Seller collects sales tax on sales price of cabinets, including installation charges unless separately stated on the invoice at time of sale
- Are the cabinets designed to suit the specific needs of the client, to fit specific space requirements, or built on-site?
 - Yes. Treated as a performance contract.
 - Seller pays sales/use tax on tangible personal property used in the performance of the contract

Carpet

- Section 31-2 of Technical Bulletins
 - General Information
 - Sale of Carpet
 - Sale and Installation of Carpet
 - Performance Contract
 - Both Contractors and Retailers May Make Retail Sales and/or Perform Contracts

Carpet

- Is carpet sold without an installation agreement?
 - Yes. Treated as a sale of tangible personal property and seller collects the tax on the sales price
 - (Carpet sold to the end consumer without an installation agreement may be the least common method, but also the easiest for tax purposes)

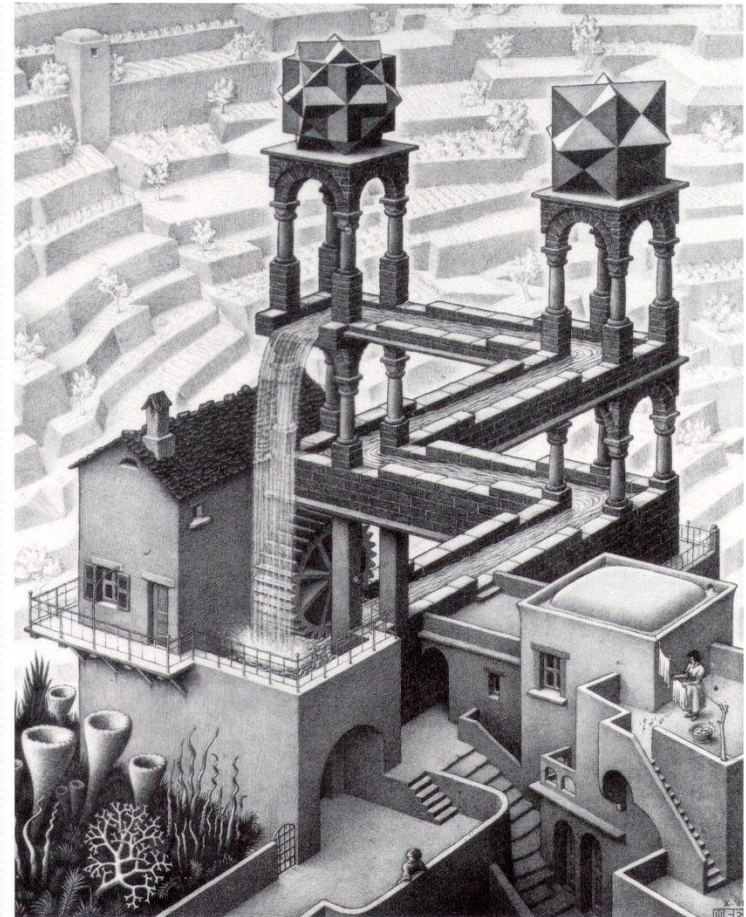


Carpet

- Retailer or contractor?
 - Does the contract specify an amount of carpet to be sold or does it specify enough carpet to cover a particular space?
 - Is exactly X square feet of carpet sold along with Y number of carpet tacks and Z amount of adhesive?
 - Yes. Treated as a sale of tangible personal property with installation
 - Seller collects sales tax on sales price of tangible personal property, including installation charges unless separately stated on the invoice at the time of sale
 - Are enough carpet and supplies sold to carpet X square feet – allowing for some variation or waste due to the shape of the room or other factors?
 - Yes. Treated as a performance contract.
 - Seller pays sales/use tax on tangible personal property used in the performance of the contract

Carpet

- Is selling and installing X square feet of carpet the same as selling and installing enough carpet to cover X square feet?
- NO!
- Different tax consequences based on the differences in the tenor of these agreements



Problem

- Department and taxpayer must make fine distinctions to determine if transaction is a sale of TPP with installation or a performance contract
- Consequences for retailer or contractor
- May result in revenue loss contrary to legislative intent



Possible solutions

- Department does not have a specific recommendation
- Subject all or most services to sales and use tax
- Clarify law around this general area
 - Tax the full sales price paid by consumer for permanently affixing tangible personal property to real estate
 - Definitively state that these types of transactions are either
 - Sales of tangible personal property with installation
 - Performance contracts
- Clarify law with respect to specific types of transactions that are most common or problematic – cabinets, countertops, flooring, roofing

Possible solutions

- Adopt specific requirements for certain types of retailers or contractors
 - Sales by certain retailers always considered to be sale of TPP with installation
 - Retailers of a certain size
 - Retailers that maintain a showroom and an inventory of goods
 - Contracts with a person required to be licensed under a State board always considered to be a performance contract

Questions

CONSTRUCTION
QUESTIONS?



CLICK NOW!